



Virginia
Regulatory
Town Hall

Proposed Regulation
Agency Background Document

Agency Name	Virginia Department of Taxation
VAC Chapter Number:	23-10-110
Regulation Title:	Individual Income Tax
Action Title:	Qualified Equity and Subordinated Debt Investment Tax Credit
Date:	November, 2000

This information is required pursuant to the Administrative Process Act (§ 9-6.14:9.1 *et seq.* of the *Code of Virginia*), Executive Order Twenty-Five (98), Executive Order Fifty-Eight (99), and the *Virginia Register Form, Style and Procedure Manual*. Please refer to these sources for more information and other materials required to be submitted in the regulatory review package.

Summary

Please provide a brief summary of the proposed new regulation, proposed amendments to an existing regulation, or the regulation proposed to be repealed. There is no need to state each provision or amendment or restate the purpose and intent of the regulation; instead give a summary of the regulatory action and alert the reader to all substantive matters or changes. If applicable, generally describe the existing regulation.

The Department of Taxation is proposing a new regulation pursuant to legislative action during the 1998 session of the General Assembly. The Qualified Equity and Subordinated Debt program is a new economic development tool to stimulate capital investment in small businesses located in the Commonwealth. The tax credit has a statewide cap of \$5 million. Individuals who invest in qualified businesses can earn a tax credit of up to 50% of their investment.

Basis

Please identify the state and/or federal source of legal authority to promulgate the regulation. The discussion of this statutory authority should: 1) describe its scope and the extent to which it is mandatory or discretionary; and 2) include a brief statement relating the content of the statutory authority to the specific regulation. In addition, where applicable, please describe the extent to which proposed changes exceed federal minimum requirements. Full citations of legal authority and, if available, web site addresses for locating the text of the cited authority must be provided. Please state that the Office of the Attorney General has certified that the agency has the statutory authority to promulgate the proposed regulation and that it comports with applicable state and/or federal law.

Virginia Code § 58.1-203 authorizes the Commissioner of the Department of Taxation to promulgate regulations relating to the interpretation and enforcement of the laws of the Commonwealth governing taxes administered by the department. In addition §58.1-339.4(G) of the Code of Virginia requires the Department to promulgate a regulation governing the Qualified Equity and Subordinated Debt Program.

The Office of the Attorney General has certified that the agency has the statutory authority to promulgate the proposed regulation and it comports with applicable state law.

Purpose

Please provide a statement explaining the need for the new or amended regulation. This statement must include the rationale or justification of the proposed regulatory action and detail the specific reasons it is essential to protect the health, safety or welfare of citizens. A statement of a general nature is not acceptable, particular rationales must be explicitly discussed. Please include a discussion of the goals of the proposal and the problems the proposal is intended to solve.

The Department of Taxation is promulgating a new regulation 23 VAC 10-110-225 et seq. governing the Qualified Equity and Subordinated Debt Investments Tax Credit Program. An emergency regulation adopted by the Department expired in February 2000.

The 1998 session of the General Assembly enacted Chapter 491 that established a new program in the Commonwealth to stimulate capital investment in selected small businesses. The Qualified Equity and Subordinated Debt program provides for a maximum tax credit equal to 50% of the amount of the investment. The amount of the credit that may be taken in any taxable year is limited to the lesser of the income tax imposed on the taxpayer for the taxable year, or \$50,000. The proposed regulation sets forth the operating procedures of the program including the process for applying for the credit, what types of businesses are eligible and ineligible, and the procedures to be used to ensure that the dollar volume of tax credits requested for a given taxable year does not exceed the statutory limit of \$5,000,000.

The Department has concluded that the regulation is essential for the efficient and economical performance of this economic development incentive. The regulation is necessary to

comply with the statutory provisions of Virginia Code § 58.1-339.4. The emergency regulation promulgated under this mandate has expired. It is essential that the Department promulgate a permanent regulation to outline the tax credit application and allocation procedures for both qualified small businesses and their individual investors.

Substance

Please identify and explain the new substantive provisions, the substantive changes to existing sections, or both where appropriate. Please note that a more detailed discussion is required under the statement providing detail of the regulatory action's changes.

The proposed regulation sets forth the procedures to be used to qualify for the Qualified Equity and Subordinated Debt Tax Credit Program. The program, effective for taxable years beginning on and after January 1, 1999, is designed to stimulate capital investment in selected small businesses that meet the statutory eligibility guidelines. The credit is available to a taxpayer in a taxable year is limited to the lesser of the tax imposed for the taxable year or \$50,000. Where the aggregate amount of the requested credits for investments made in a calendar year exceed \$5 million, the Department will allocate the available tax credits pro rata among the approved tax credit applicants. Unused credits may be carried forward to offset future income tax liability for up to 15 taxable years.

Issues

Please provide a statement identifying the issues associated with the proposed regulatory action. The term "issues" means: 1) the primary advantages and disadvantages to the public, such as individual private citizens or businesses, of implementing the new or amended provisions; 2) the primary advantages and disadvantages to the agency or the Commonwealth; and 3) other pertinent matters of interest to the regulated community, government officials, and the public. If there are no disadvantages to the public or the Commonwealth, please include a sentence to that effect.

There are no disadvantages to the public or the Commonwealth as a result of the implementation of this program.

Fiscal Impact

Please identify the anticipated fiscal impacts and at a minimum include: (a) the projected cost to the state to implement and enforce the proposed regulation, including (i) fund source / fund detail, (ii) budget activity with a cross-reference to program and subprogram, and (iii) a delineation of one-time versus on-going expenditures; (b) the projected cost of the regulation on localities; (c) a description of the individuals, businesses or other entities that are likely to be affected by the regulation; (d) the agency's best estimate of the number of such entities that will be affected; and e) the projected cost of the regulation for affected individuals, businesses, or other entities.

For taxable year 1999, 164 taxpayers applied for and were approved for this credit. Requested credits totaled \$8.2 million, exceeding the \$5 million cap in the statute. Each of these investors received 60.67% of their requested credit. In addition, 62 small businesses had investments that qualified for participation in the program. Applications received so far this year for taxable year 2000 indicate that the cap will again be exceeded, and approved applicants will receive a prorated credit.

There will be no additional cost to the Department to implement the proposed regulation. The tax credit has been in effect since 1998, and is accounted for in the revenue projections the Department prepares for the Governor's budget. In the 2000 session of the General Assembly, funds were provided to administer existing and prospective income tax credits, including the three existing capped credit programs. The start-up cost for this program is estimated at \$203,000.

Detail of Changes

Please detail any changes, other than strictly editorial changes, that are being proposed. Please detail new substantive provisions, all substantive changes to existing sections, or both where appropriate. This statement should provide a section-by-section description - or cross-walk - of changes implemented by the proposed regulatory action. Where applicable, include citations to the specific sections of an existing regulation being amended and explain the consequences of the proposed changes.

Small businesses that meet the statutory qualifications must submit an application to the Department. "Qualified" businesses are required to have gross revenues less than \$5 million, be domiciled in Virginia, and have their primary place of business in Virginia. Businesses which are ineligible include, but are not limited to, financial institutions, professional services corporations, governmental and charitable institutions, real estate firms and business consulting firms.

Although the statute establishes the parameters of the program, the regulation is necessary to set forth the Department's procedures with respect to claiming the tax credit and providing for the allocation of tax credits among taxpayers should the number of requests exceed the available amount of credits. If the number of credits claimed exceeds the amount of available credits, each taxpayer will receive a prorated credit in proportion to their share of the total available credits. For example, if \$6 million in tax credits are applied for with respect to a taxable year, each taxpayer would be able to claim only 5/6 of the earned credit. The credit may be taken in annual increments of up to \$50,000 for up to 15 years.

The process for claiming the credit is also outlined in the regulation. In order to make a claim for the tax credit, an investor must obtain a copy of the qualified business's certification and submit such certification when claiming the credit. The certification may be obtained by the qualified business by application to the Department of Taxation.

Alternatives

Please describe the specific alternatives to the proposal considered and the rationale used by the agency to select the least burdensome or intrusive alternative that meets the essential purpose of the action.

The Department has issued Virginia Tax Bulletin 00-5 that provides general guidance to the public about the program; however, it does not satisfy the requirement of the statute that the Department promulgates a regulation.

Public Comment

Please summarize all public comment received during the NOIRA comment period and provide the agency response.

No public comment was received on the Notice of Intended Regulatory Action.

Clarity of the Regulation

Please provide a statement indicating that the agency, through examination of the regulation and relevant public comments, has determined that the regulation is clearly written and easily understandable by the individuals and entities affected.

The Department contacted interested parties to review and comment on an exposure draft of this proposed regulation. During the Notice of Intended Regulatory Action comment period the Department did not receive any feedback.

Periodic Review

Please supply a schedule setting forth when the agency will initiate a review and re-evaluation to determine if the regulation should be continued, amended, or terminated. The specific and measurable regulatory goals should be outlined with this schedule. The review shall take place no later than three years after the proposed regulation is expected to be effective.

The proposed regulation will be reviewed three years subsequent to its effective date. The following will be used as indicators of the regulation’s effectiveness: increased/decreased use of this economic development incentive; taxpayer comments on/complaints about the regulatory provisions; the volume of questions/ruling requests received; and litigation.

Family Impact Statement

Please provide an analysis of the proposed regulatory action that assesses the potential impact on the institution of the family and family stability including the extent to which the regulatory action will: 1) strengthen or erode the authority and rights of parents in the education, nurturing, and supervision of their children; 2) encourage or discourage economic self-sufficiency, self-pride, and the assumption of

responsibility for oneself, one's spouse, and one's children and/or elderly parents; 3) strengthen or erode the marital commitment; and 4) increase or decrease disposable family income.

This proposal will have no effect on: 1) the authority and rights of parents in education, nurturing, and supervision of their children; 2) the economic self-sufficiency, self-pride, and the assumption of responsibility for oneself, one's spouse, one's children, and/or one's elderly parents; 3) marital commitment; and/or 4) disposable family income.